



**NASAA**

**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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April 23, 2004

Jonathan Katz, Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Via e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**Re: File No. S7-08-04; Release Nos. 33-8364; 34-49219; IC-26350  
Disclosure Regarding Approval of Investment Advisory Contracts by Directors of  
Investment Companies**

Dear Mr. Katz:

The North American Securities Administrators Association, Inc. (NASAA)<sup>1</sup> is pleased to submit comments regarding the above proposal. We appreciate the opportunity to comment on amendments the Commission is considering to its rules relating to registered management investment companies (“funds”) under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. The proposal addresses how a fund’s Board of Directors (“Directors”) evaluates, approves and recommends an investment advisory contract (“advisory contract”) to shareholders for approval.

The proposed amendments by the Commission would include:

1. Improved disclosures in funds’ registration statements that would detail the basis for the Directors’ approval of any existing advisory contract.
2. Improved disclosure requirements in funds’ Statements of Additional Information (“SAIs”) and proxy statements. Funds would have to discuss the selection of an adviser, approval of advisory fees, specific factors considered, comparison of fees and services provided by advisers, and evaluation of factors. These would parallel the proposed disclosures in the shareholder reports.
3. Additional disclosures in the funds’ shareholder reports to discuss, in reasonable detail, the material factors, and conclusions that formed the basis of the Directors’ approval of an advisory contract during the designated reporting period.

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

NASAA supports the Commission's vigorous pursuit of requiring additional and improved disclosures, as well as increased independent oversight by Directors of the approval process for funds' advisory contracts. The steps taken by the Commission to encourage fair and reasonable transparency with respect to fund advisory contracts and management fees for advisory services is commendable. This action will strengthen investor protection and help restore investor confidence in the fund industry.

The Commission requested comments on whether any further changes to the rules or forms that would be necessary or appropriate to implement the objectives of the proposed amendments in this release. NASAA's comments will primarily focus on specific issues raised by the Commission:

- Expand the proposal to require disclosures in shareholder reports with of all investment advisory contracts approved by the board during the reporting period, including contracts that were also approved by shareholders.

NASAA believes that shareholder reports should be as comprehensive as possible for shareholders to remain up-to-date on investment advisory contract approvals, whether or not the shareholder was involved in the original approval of the contract. Most investors are more apt to review the shareholder reports on a semi-annual basis than they are to view other related documents, and the summary of investment advisory contractual information should be presented in plain English and in tabular form so the shareholder can compare key information. We also recommend requiring use of sufficiently large print as to make the disclosures easily readable.

- Disclosure regarding the basis of the Directors' approval of an advisory contract in any additional locations (e.g., the prospectus, fund websites)

Investors increasingly are turning to the Internet for information. Disclosures in both the prospectus and funds' websites are important for providing adequate, real-time information to investors when making decisions regarding their fund investments. NASAA would encourage the Commission to have funds provide web links that investors and potential investors can easily access to obtain the basis of the Directors' approval of advisory contract information. This should also include a web link to the SAI, since funds are required to offer the SAI to investors or potential investors only "upon request." NASAA does not think that "upon request" is sufficient. Investors are more apt to review the SAI if it readily accessible and requires no additional steps (e.g., dialing an 800 number to request a copy of the SAI, or searching EDGAR).

- Continuance of the SAI required disclosures with regard to the basis for the Directors' approval of an existing investment advisory contract if the proposed shareholder reports requirements are adopted, and if the SAI disclosure requirement were removed, whether or not to require funds to cross-reference information in the prospectus or the SAI to the disclosures in the shareholder reports.

NASAA does not support cross-referencing information between the funds' documents, but instead remains supportive of the additional and improved disclosures in the SAI, proxy statements and shareholder reports as suggested by the Commission.

- The appropriateness of the proposed enhancements to the existing SAI and proxy statements that are also proposed in the shareholder reports, as summarized on page 1, item #2 of this letter.

NASAA advocates that the proposed enhancements be included in the SAI and proxy statements, as well as the proposed similar disclosures for the shareholder reports.

Under “Specific Factors,” item #3 states that the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund should be discussed by the fund. NASAA believes that a fund, the investment adviser, and the adviser's affiliates have a fiduciary duty to the shareholders to not only “discuss” the costs of the services to be provided and profits to be realized, but in plain English, tally all the amounts paid or received in a tabular form by the Investment Adviser and its affiliates to adequately portray the true cost of doing business with the fund's adviser. Excessive or duplicative fees by investment advisers and their affiliations can add up to enormous amounts of money with no apparent limits when combined together.

NASAA recognizes the ongoing relationship that is formed between Directors and an investment adviser when approving a fund contract. It is of the utmost importance that the Directors and the investment adviser to the funds be kept at arm's length with respect to advisory contract negotiations and independence. We recommend that the Commission consider requiring that an investment adviser and its affiliates not be affiliated with the fund that is overseen. Precluding such affiliation would lessen conflicts of interest and reduce financial risk to shareholders.

- Comparison of Fees and Services Provided by Advisers. The Commission requests comments on whether fund Directors should be required to disclose when and why they did not compare services and fees of other investment advisers.

NASAA supports the concept that the Directors evaluate in detail the services rendered and the fees stated in the contract and compare the results to other similar investment adviser contracts. This should not be optional; there should be a requirement to compare services and fees. Based on this comparison, the Director's would be required to recommend to the shareholder's for approval the overall contract that best suits the needs of the shareholders.

Thank you for consideration of these views. Should you have questions about NASAA's comments, please feel free to contact Patricia Struck, Chair of the NASAA Investment Adviser Section and Director of the Wisconsin Division of Securities or Kristina Kneip, Chair of NASAA's Investment Adviser Regulatory Policy and Review Project Group and Senior Examination Attorney with the Washington State Securities Division.

Sincerely,

*Ralph A. Lambiase*

Ralph A. Lambiase  
NASAA President and  
Director, Connecticut Division of Securities